NO. 49347-1-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

KING COUNTY, Appellant,

v.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, a Washington state agency, and PUGET SOUND ENERGY, Respondents.

BRIEF OF RESPONDENT WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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I. INTRODUCTION

This case is about utility ratemaking and the fair allocation of costs between disparate Puget Sound Energy ("PSE") customers. Specifically, it concerns whether the costs of replacing a unique electric distribution system that provides service to a remote mountain ridge should be assigned equally to a large class of nonresidential customers or to the four PSE customers (collectively, the "Maloney Ridge Customers")[1] who alone take power from the system and who have paid all of its historic costs.

To distract this Court from the facts bearing on rates, the Maloney Ridge Customers attempt to shoehorn this Court's review into a "plain language" analysis of PSE's Tariff Schedule 85. But Schedule 85 does not control who should pay the Maloney Ridge system's replacement costs as a matter of law. Rather, the Washington Utilities and Transportation Commission had a statutory duty to balance the equities through a fact-based analysis and to determine a just and reasonable result. RCW 80.28.020 (Commission must fix just, reasonable, and compensatory rates); RCW 80.28.100 (rate discrimination prohibited).

The Commission reached the only conclusion that was consistent with the peculiar facts of this case and with its statutory obligation to

[1] The Maloney Ridge Customers are represented before this Court by the nominal appellant, King County.

establish just and reasonable rates for PSE's electric service. The Commission properly assigned the lion's share of replacement costs to the Maloney Ridge Customers.

The undisputed facts strongly favored the Commission's decision to allocate the uneconomic costs of the system's replacement to the Maloney Ridge Customers. Any other decision would have been unjust and unreasonable under RCW 80.28. This Court should affirm the Commission's final Order 04 to avoid an unwarranted windfall to the Maloney Ridge Customers and the corresponding harms to the non-benefitting Schedule 24 customers.

II. RESTATEMENT OF THE ISSUES

Did the Commission act arbitrarily or capriciously or commit an error of law when it determined that its statutory obligation to regulate electric rates in the public interest prevented it from allocating Maloney Ridge Distribution System replacement costs to certain nonresidential customers who indisputably receive no benefit from the system, an outcome that would confer an unwarranted windfall to the four Maloney Ridge Customers who alone take power from the system and who have always paid for its costs?

III. RESTATEMENT OF THE CASE

The following facts are undisputed.[2]

A. The Maloney Ridge Distribution System is Unique

The Maloney Ridge Distribution System ("System") is a single phase primary voltage electric distribution system located mostly underground in a remote section of the Snoqualmie National Forest. AR 329, 626, 754. The System originates at a primary metering point along Foss River Road in Skykomish, Washington, and extends 8.5 miles up steep mountainous terrain to Maloney Ridge, where several communication towers are located. AR 34-35, 41-42, 626, 755. Heavy snowpack covers the terrain for several months each year, and rockslides and other rock movements that affect the System are common. AR 755-56. Safe weather conditions and heavy equipment are necessary to access and repair the underground System. AR 757.

PSE originally constructed the System for General Telephone Company of the Northwest, Inc. ("GTE") pursuant to a 1971 agreement. AR 329. From PSE's perspective, the System was not economically feasible to build due to the small electric load (i.e., demand for power), high cost of

[2] In their petition for judicial review, the Maloney Ridge Customers assigned no error to any of the Commission's findings. The superior court confirmed in its Order Affirming Final Agency Action, "WUTC's Findings of Fact set forth in [final] Order 04 are unchallenged." (A copy of the superior court's order is attached to the Maloney Ridge Customers' notice of appeal.)

installation, limited operational rights in the national forest, and expected exorbitant maintenance costs given the System's location. AR 603. Accordingly, the 1971 agreement required GTE to pay the actual costs incurred by PSE in constructing, maintaining, and removing the System. AR 612-18. The agreement did not expressly reserve any cost to PSE. *Id.*

B. The Maloney Ridge System Now Serves Four Customers Pursuant to Service Agreements and PSE's Electric Tariff

The Maloney Ridge Distribution System now serves four PSE customers: GTE, BNSF Railway, King County, and the Maloney Ridge Users Association (collectively, "Maloney Ridge Customers"). AR 329, 597. The Maloney Ridge Customers each receive service in accordance with a service agreement executed in the mid-1990s (collectively, "Service Agreements") and under the provisions of PSE's Electric Tariff G. AR 597-98. All agreements between the Maloney Ridge Customers and PSE that predate the Service Agreements are now void. *See* AR 626.

The Service Agreements govern the operation of the System and the recovery of its costs. AR 626. PSE is responsible for performing all repair and maintenance necessary "to keep the System in good operating condition." AR 626. But "[a]s authorized by the economic feasibility provisions (paragraph 13) of Schedule 85 of Puget's Electric Tariff G," the Maloney Ridge Customers share all the costs associated with keeping the

System in good operating condition. AR 626-27. The Service Agreements further require that any new customer receiving service from the System must become a party to the Service Agreements and pay a share of the System's costs. AR 628. If service to Maloney Ridge is ever terminated, PSE will remove the System and all Maloney Ridge Customers must pay an equal share of the actual costs to remove it. *Id.* No party disputes the Commission's finding in Order 04 that "[the Maloney Ridge Customers] have been and remain exclusively responsible for the costs of the [System]." AR 329.

The Maloney Ridge Customers receive their electric service under general rate Schedule 24 of PSE's Electric Tariff G. AR 329. Schedule 24 is a general service tariff available to non-residential customers with low demand for electricity (specifically, a peak instantaneous demand of 50 kilowatts or less). AR 598. PSE provides electric service to approximately 115,000 non-residential customers under Schedule 24. AR 598. Schedule 24 establishes rates for such service and is the mechanism by which PSE recovers a share of its fixed and variable costs, including power costs and transmission and distribution system costs, from each non-residential customer. AR 329, 598, 673. The Schedule 24 rate includes the cost of delivering power through PSE's general distribution system to the starting point of the Maloney Ridge System. AR 814. No System cost—i.e.,

no cost beyond the System's starting point—has ever been included in Schedule 24 rates or in the rates of any other PSE tariff schedule. AR 329, 332. The Maloney Ridge Customers have always borne System costs pursuant to their Service Agreements.

C. The Maloney Ridge Customers Want the System Replaced Because Its Useful Life Is Nearly Over

The Maloney Ridge System "may be nearing the end of its useful life." AR 330. It has experienced increasingly frequent failures and, consequently, escalating repair costs. AR 330, 427. So far, system failures have not impaired the Maloney Ridge Customers' communication facilities because backup generation is available on site. AR 671.

PSE identified five options for improving the System's reliability, ranging from partial to total replacement of the underground cable. PSE consulted with the Maloney Ridge Customers regarding these options. AR 427, 440-47. The Maloney Ridge Customers rejected all options except total replacement. AR 428.

D. Replacing the System is Not Economically Feasible for PSE

It is undisputed that replacement, as with the System's original construction, is not economically feasible. The cost to replace the System is approximately $5.3 million. AR 330. Based on the Maloney Ridge Customers' current electricity usage and willingness to pay for operations

and maintenance costs going forward, PSE can expect to recover no more than $335,000 of the replacement cost through future rate payments. AR 336, 950. Even extraordinary 500% electric load growth on the System would not render the investment economically feasible. AR 794-96, 946.

E. The Maloney Ridge Customers Demand That PSE Replace the System and Spread the Costs among All Schedule 24 Customers

Even though replacement is not economically feasible for PSE, the Maloney Ridge Customers have demanded that outcome. They have also demanded that PSE spread the costs among all Schedule 24 customers. AR 332. If the Commission were to approve both demands, the $5.3 million replacement cost would be spread across approximately 115,000 Schedule 24 customers, rather than just the four Maloney Ridge Customers. The Maloney Ridge Customers would benefit because they would pay only a "*de minimis* 0.2 percent" electric rate increase for the System's replacement. *See* AR 238.

F. The Maloney Ridge Customers Petitioned the Commission to Determine Who Should Pay to Replace the System

The Maloney Ridge Customers, including King County, jointly petitioned the Commission for a declaratory order addressing the System's degradation of service and the allocation of replacement costs. AR 4-5. They requested that "the Commission issue an order applying and interpreting RCW 80.28.010, Schedule 85 of PSE's Electric Tariff G, [and]

certain Service Agreements . . . and provide such other and further ratepayer relief as the Commission may deem necessary and appropriate under the circumstances." AR 7.

G. The Commission Determined the Maloney Ridge Customers Should Pay to Replace the System

After failed settlement discussions, multiple rounds of written testimony, an evidentiary hearing, and briefing, the Commission's Administrative Law Judge ("ALJ") issued initial Order 03 granting the Petition in part and denying it in part. The ALJ began his analysis by stating: "The parties offer several grounds on which they contend the Commission should adopt their respective positions, most of which are not persuasive." AR 240. The ALJ found that the Service Agreements and PSE's tariff "did not resolve the issue of who should pay the costs to replace the Maloney Ridge [System] as a matter of law." The ALJ accordingly undertook a fact-based analysis of the circumstances of the case and concluded that the weight of relevant facts established that Maloney Ridge Customers should pay the System's replacement costs. AR 247.

Initial Order 03 required PSE, at the request of the Maloney Ridge Customers, to replace the System. It further required the Maloney Ridge Customers to pay all construction costs in excess of $335,000 as well as all

operating and maintenance expenses for the System pursuant to the terms and conditions of the existing Service Agreements. AR 250.

The Maloney Ridge Customers sought administrative review of Initial Order 03 before the three-member Commission. AR 254. They argued that Order 03 erred by (1) concluding that the System is not part of PSE's distribution system, and (2) determining that PSE's tariff is not dispositive of whether PSE must pay to replace the System. *See* AR 255.

The Commission issued final Order 04 denying the petition for administrative review. Order 04 refuted the Maloney Ridge Customers' two claims of error and adopted the Findings and Conclusions in Order 03. AR 330-38.

H. The Maloney Ridge Customers Appealed

Two of the Maloney Ridge Customers, BNSF and King County, sought judicial review in Thurston County Superior Court under the Administrative Procedure Act, RCW 34.05. The superior court affirmed the Commission's final Order 04.[3]

King County then appealed to this Court.

[3] The superior court's order is attached to the Maloney Ridge Customers' notice of appeal.

IV. ARGUMENT

To avoid an unwarranted windfall to the Maloney Ridge Customers and the corresponding harms to the non-benefitting Schedule 24 customers, the Commission properly assigned the uneconomic replacement costs to the four Maloney Ridge Customers who alone benefit from the System and who alone have paid all of its costs to date.

The Maloney Ridge Customers petitioned the Commission to answer fact-based ratemaking questions concerning cost allocation between disparate PSE customers. Specifically, they asked the Commission to decide, before any replacement costs were incurred, which of PSE's nonresidential customers should pay to replace the Maloney Ridge System: all Schedule 24 customers or the four Maloney Ridge Customers who alone take power from the System and who have paid all of its historic costs. This question indisputably implicated the Commission's general ratemaking authority under Title 80 RCW. Normally, this question would be addressed in a general rate case after replacement was complete.

The Commission properly addressed the Maloney Ridge Customers' ratemaking question using a fact-based analysis that considered all relevant factors, including how the System's costs were historically allocated, whether replacement was economically feasible for PSE, and the rate impact that replacement would have on the large class of Schedule 24

customers. After thoroughly considering the facts presented and its statutory duty under RCW 80.28 to establish fair, just, and reasonable rates, the Commission correctly determined that the Maloney Ridge Customers should incur the lion's share of the System's replacement costs. Accordingly, the Commission assigned all of the uneconomic System replacement costs (i.e., costs above what PSE can expect to recover through the sale of electricity) to the Maloney Ridge Customers.

Dissatisfied with this result, the Maloney Ridge Customers now ask this Court to second-guess the Commission's ratemaking judgment. In this pursuit, the Maloney Ridge Customers advance a legalistic argument about the construction of PSE's Tariff Schedule 85 that is designed to blind this Court to the unique facts of the case and to distract it from the Commission's paramount statutory duty to establish just, fair, reasonable, and sufficient utility rates. RCW 80.28.010, .020.

Ultimately, the Maloney Ridge Customers' argument fails because this is a ratemaking case—not a tariff or contract case. Their textual construction argument suffers from three fundamental flaws: (1) they misread the plain language Schedule 85; (2) they ignore the plain language of Schedule 80, which is expressly incorporated into Schedule 85; and (3) most importantly, they neglect the Commission's statutory responsibility, which is to arrive at a just, fair, reasonable, and sufficient

result. Moreover, their desired outcome—that all Schedule 24 customers share equally the costs to replace the Maloney Ridge System—is unlawful because it would produce unjustly discriminatory rates for the Schedule 24 customers that take no power from the System.

This Court should affirm the Commission's decision to avoid an unwarranted windfall to the Maloney Ridge Customers and the corresponding harms to the non-benefitting Schedule 24 customers.

A. Standard of Review

This Court reviews the Commission's final order under the standards set forth in the Administrative Procedure Act, RCW 34.05. *US W. Commc'ns, Inc. v. Wash. Utils. & Transp. Comm'n*, 134 Wn.2d 74, 85, 949 P.2d 1337 (1997). The party asserting the invalidity of agency action has the burden of demonstrating error. RCW 34.05.570(1)(a); *PacifiCorp v. Wash. Utils. & Transp. Comm'n*, 194 Wn. App. 571, 586, 376 P.3d 389 (2016). The reviewing court presumes the agency reached the correct decision. *Kadlec Reg'l Med. Ctr. v. Dep't of Health*, 177 Wn. App. 171, 177, 310 P.3d 876 (2013).

Under the APA, judicial relief from an adjudicative order is available in nine enumerated circumstances. RCW 34.05.570(3). The Maloney Ridge Customers fail to cite the APA in their assignments of error. Nevertheless, it appears that they intended to invoke two avenues of APA

relief. First, they allege that the Commission's final Order 04 was "arbitrary or capricious" within the meaning of RCW 34.05.570(3)(i). Br. of Appellant at 1-3 (Assignments of Error 1-6). Second, they allege that the Commission committed several "errors of law." *Id.* (Assignments of Error 1-6). Presumably, they intended to allege that the Commission "erroneously interpreted or applied the law" within the meaning of RCW 34.05.570(3)(d).

The arbitrary or capricious standard favors the agency. *ARCO Prods. Co. v. Utils. & Transp. Comm'n*, 125 Wn.2d 805, 812, 888 P.2d 728 (1995) (arbitrary or capricious standard is "highly deferential). The reviewing court upholds the agency's decision unless it constitutes "'willful and unreasoning action, taken without regard to or consideration of the facts and circumstances surrounding the action.'" *Spokane County v. E. Wash. Growth Mgmt. Hearings Bd.*, 176 Wn. App. 555, 565-66, 309 P.3d 673 (2013) (quoting *City of Redmond v. Cent. Puget Sound Growth Mgmt. Hearings Bd.*, 136 Wn.2d 38, 46-47, 959 P.2d 1091 (1998)). "'Where there is room for two opinions, an action taken after due consideration is not arbitrary and capricious even though a reviewing court may believe it to be erroneous.'" *Spokane County*, 176 Wn. App. at 566 (quoting *City of Redmond*, 136 Wn.2d at 47). The reviewing court "'will not set aside a discretionary decision absent a clear showing of abuse.'" *ARCO Prods.*, 125

Wn.2d at 812 (quoting *Jensen v. Dep't of Ecology*, 102 Wn.2d 109, 113, 685 P.2d 1068 (1984)); RCW 34.05.574(1).

On questions of law, this Court applies the error of law standard. *Verizon Nw., Inc. v. Emp't Sec. Dep't*, 164 Wn.2d 909, 915, 194 P.3d 255 (2008). Under this standard, the court need not accept the agency's interpretation of a statute. *PT Air Watchers v. Dep't of Ecology*, 179 Wn.2d 919, 925, 319 P.3d 23 (2014). Still, the court will defer to the agency's interpretation "where the agency has specialized expertise in dealing with such issues." *PT Air Watchers*, 179 Wn.2d at 925 (quoting *City of Redmond*, 136 Wn.2d at 46). In particular, courts have consistently declined to second-guess the Commission's economic judgments. *See, e.g.*, *PacifiCorp*, 194 Wn. App. at 588-89; *Wash. Att'y General's Office v. Utils. & Transp. Comm'n*, 128 Wn. App. 818, 824, 116 P.3d 1064 (2005); *Wash. Indep. Tel. Ass'n v. Utils. & Transp. Comm'n*, 110 Wn. App. 498, 516, 41 P.3d 1212 (2002). In this Court's words, the Commission "retains broad authority to regulate the rates, services, and practices of companies providing electricity service in the state of Washington." *Att'y General's Office*, 128 Wn. App. at 825.

The Maloney Ridge Customers additionally allege that the Commission acted "inconsistent with its own precedent." Br. of Appellant at 2 (Assignment of Error 2). This allegation is problematic. Administrative

agencies should "strive for equality of treatment," but they are not bound by prior decisions to the extent that any deviation from the decision on its face constitutes unlawful action under the APA. *Kittitas Cnty.* v. *E. Wash. Growth Mgmt. Hearings Bd.,* 172 Wn.2d 144, 173 n.9, 256 P.3d 1193 (2011) (quoting *Vergeyle* v. *Dep't of Emp't Sec.,* 28 Wn. App. 399, 404, 623 P.2d 736 (1981)). Stated differently, there is no "cause of action" under the APA for acting inconsistently with precedent. The real question is whether the deviation, if any, was so egregious as to be arbitrary or capricious.

For the reasons discussed below, the Commission's final Order 04 was not arbitrary or capricious, and it contained no error of law.

B. The Commission Properly Executed Its Ratemaking Authority to Determine That the Maloney Ridge Customers Should Pay to Replace the System

Fundamentally, this is a ratemaking case. The Maloney Ridge Customers petitioned the Commission to resolve two questions affecting rates: (1) whether PSE had a duty to replace the System that serves the Maloney Ridge Customers; and (2) if so, which PSE customers should pay the System's replacement cost: the Maloney Ridge Customers or all of PSE's Schedule 24 customers. *See* AR 5. Both questions required the Commission to undertake a fact-based analysis to determine a fair, just, reasonable, and sufficient result. *See* RCW 80.28.010, .020.

1. The Maloney Ridge Customers Petitioned the Commission to Resolve Rate Questions, Which Required a Hearing to Develop Facts Prior to Commission Action

The Maloney Ridge Customers asked the Commission to resolve ratemaking questions. Their petition expressly invoked the statutory provisions that establish the Commission's ratemaking authority, including: RCW 80.01.040 (general powers and duties); RCW 80.28.010 (duties as to rates, services, and facilities); RCW 80.28.020 (Commission must fix just, reasonable, and compensatory rates); RCW 80.28.100 (rate discrimination prohibited); and RCW 80.28.130 (repairs, improvements, changes, additions, or extensions may be directed). AR 7. Two of these statutory provisions—RCW 80.28.020 and RCW 80.28.130—required a hearing prior to Commission action. *See* AR 73-74, 78.

Recognizing that the Commission had authority to answer their rate questions only after a hearing, the Maloney Ridge Customers affirmatively requested that the Commission convert their petition for declaratory judgment into an adjudicative proceeding to develop the factual record necessary to support the Commission's final order. Tr. 6:13-6; *see* AR 74, 88. The Maloney Ridge Customers' petition also expressly asked the Commission to exercise its ratemaking authority under RCW 80.28.010. AR 7, 24. The Maloney Ridge Customers thus recognized from the start that

the proceeding involved fact-based ratemaking questions, and that the Commission's decision required a fact-based analysis.

In a footnote, the Maloney Ridge Customers cite *Northern Pacific Railway Company v. Sauk River Lumber Company*, 160 Wash. 691, 295 P. 926 (1931), for the proposition that "this is a tariff and contract interpretation—not ratemaking—case." Br. of Appellant at 49 n.55. Their reliance on *Northern Pacific Railway* is misplaced. *Northern Pacific Railway* involved a dispute about whether a railroad company overcharged a lumber company for a shipment of logs pursuant to a tariff. In *Northern Pacific Railway Company*, the Department of Public Works had to determine if a ***past*** charge was correctly calculated pursuant to a properly filed tariff. In contrast, the Maloney Ridge Customers asked the Commission to decide ***prospectively*** whether PSE should replace the System, and, if so, who should bear the cost.[4] The Commission's ratemaking authority is legislative in character. *PacifiCorp*, 194 Wn. App. at 587. Therefore, it was not constrained by a tariff schedule or contract subject to its regulation; rather, its statutory duty was to proscribe a fair, just, reasonable, and sufficient result. RCW 80.28.010, .020.

[4] Of note, no record evidence exists that the Service Agreements were ever properly filed with the Commission pursuant to RCW 80.28.050 and WAC 480-100-028.

2. The Public Service Laws Direct the Commission to Set Just, Fair, Reasonable and Sufficient Rates that Are Not Unduly Discriminatory or Preferential

Ratemaking questions require a fact-based analysis. The Legislature empowered the Commission to "[r]egulate in the public interest, as provided by the public service laws, the rates, services, facilities, and practices of all persons . . . supplying any utility service." RCW 80.01.040(3). The Commission's "paramount objective . . . [is] to secure for the public safe, adequate, and sufficient utility services at just, fair, reasonable, and sufficient rates." *People's Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm'n*, 104 Wn.2d 798, 808, 711 P.2d 319 (1985); RCW 80.28.010. Rates also cannot be unjustly discriminatory or unduly preferential. RCW 80.28.020, .090, .100. Each of these ratemaking objectives is equally important in the eyes of the law. *See People's Org. for Wash. Energy Res.*, 104 Wn.2d at 808.

"The function of rate-making is legislative in character, and the judicial branch is not empowered to undertake the job of fixing rates." *PacifiCorp*, 194 Wn. App. at 587. The Commission may revise rates prospectively, but not retroactively. *See* RCW 80.04.130. "The basic premise underlying the prohibition against retroactive ratemaking is that the setting of utility rates is a legislative function, even if carried out by administrative agency; therefore, utility rates, like any other legislation,

generally can have only prospective application and cannot be used to recoup losses or gains incurred under prior legal rates." 73B C.J.S. *Public Utilities* § 141; *see also Tenore v. AT & T Wireless Servs.*, 136 Wn.2d 322, 331, 962 P.2d 104 (1998) (discussion of "filed rate" doctrine). Before revising rates prospectively, the Commission must hold a hearing to determine whether the rate change is just and reasonable. RCW 80.04.130, RCW 80.28.020.

"The Commission has broad generalized powers in rate setting matters." *US W. Commc'ns, Inc. v. Wash. Utils. & Transp. Comm'n*, 134 Wn.2d at 56 (1997). In rate cases, the Commission determines the aggregate costs that comprise the utility's allowed revenue requirement and based thereon "establishes the maximum rates the utility can charge for its products to each class of customers." *People's Org. for Wash. Energy Res.*, 104 Wn.2d at 809. "A major goal of cost allocation is the avoidance of cross-subsidization between classes of customers . . . ." Leonard Saul Goodman, *The Process of Ratemaking*, 374 (1998). To achieve this goal, the Commission must establish that rates "yield a reasonable compensation for the service rendered." *See* RCW 80.28.020.

Importantly, whenever the Commission finds, after a hearing, that a utility's rates, practices, or contracts "are unjust, unreasonable, unjustly discriminatory or unduly preferential . . . or that such rates or charges are

insufficient to yield a reasonable compensation for the service rendered" it must "determine the just, reasonable, or sufficient rates, charges, regulations, practices or contracts to be thereafter observed and in force" and must "fix the same by order." RCW 80.28.020. The Commission, therefore, is not restricted by the rates, practices, or contracts currently in effect when making prospective ratemaking decisions. Rather, ratemaking questions require the Commission to develop the facts necessary to arrive at a just, fair, reasonable, and sufficient result.

3. The Commission Properly Applied a Fact-Based Analysis, Which Considered, Among Other Factors, the Economic Feasibility of Replacing the System

The Maloney Ridge Customers argue that the Commission improperly undertook a fact-based analysis to determine which of PSE's Schedule 24 customers should pay the System's replacement costs. Br. of Appellant at 37-43. Specifically, they argue: (1) the Commission improperly considered the "economic feasibility" of replacing the System, and (2) the Commission may engage in a fact-based analysis only when analyzing the costs of new or additional service (as opposed to replacement costs). The Maloney Ridge Customers are mistaken on both counts. The Commission properly undertook a fact-based analysis to determine what was just and reasonable based on the unique facts of the case.

The purpose of the Commission's rules is to administer and enforce RCW 80.28. WAC 480-100-001. As discussed, RCW 80.28 directs the Commission to fix just, fair, reasonable, and sufficient terms and conditions for utility service. RCW 80.28.010, .020. The Commission also had to ensure PSE serves all persons "reasonably entitled" to utility service. RCW 80.28.110. And that rates "yield a reasonable compensation for the service rendered . . ." RCW 80.28.020. The Commission thus was required to consider whether replacing the System was economically feasible.

The Commission acted consistently with its refusal of service rule (WAC 480-100-123) by applying a fact-based analysis that considered economic feasibility as one of several factors. WAC 480-100-123 is based on—and incorporates—the utility's general obligation to serve all persons "reasonably entitled" to utility service. RCW 80.28.110. In the rulemaking that promulgated WAC 480-100-123, the Commission declined to include an "overly prescriptive" provision addressing economic feasibility in the rule because "resolution of obligation to serve issues is likely to be based on ***fact-specific analysis***." *In re Adopting and Repealing Rules in Chapter 480-100 WAC Relating to Rules Establish Requirements for Electric Companies*, UE-990473, Order No. R-495, Order Adopting and Repealing Rules Permanently, ¶¶ 15, 25 (Dec. 3, 2001) (emphasis added). Instead, the Commission provided a "catch all" provision to allow a utility to file for

approval if it wished to refuse service for economic reasons. *Id.* at ¶¶ 25-26. In promulgating its refusal of service rule, the Commission found that economic feasibility should not be determinative without broader consideration of the facts and circumstance of the case. Consistent with it rulemaking order and rule, the Commission refused to consider economic feasibility in isolation and without broader analysis of the facts and circumstance of the case. AR 335, 337. While not determinative, economic feasibility was a necessary component of the Commission's analysis.

The Supreme Court of Connecticut cogently distilled how economic feasibility factors into an obligation to serve analysis. In *Levitt v. Public Utilities Commission*, the court affirmed an order of the public utilities commission declining to force a utility to furnish electric service at the customer's home, which was on a seldom-used country road. 114 Conn. 628, 159 A. 878, 879 (1932). The utility would have incurred extraordinary costs to provide a line "through woods and rocky soil" to the customer's home. *Id.* Nevertheless, the customer argued that the utility was obligated to serve all within its territory "without discrimination in rates, provided it can do so without materially affecting its financial or rate structure." *Id.*

The court disagreed. It found that application of such a principle "impracticable" because eventually a situation would arise where the construction of further extensions would affect the utility's financial and

general rate structure, and thus it "would merely postpone the application of the test of the reasonableness of requiring the particular extension." *Id.* The court held that the commission's decision was governed by a reasonableness standard in view of all the circumstances of the case:

> The question of a [utility's] duty is not one which is determinable by the application of any such simple test as, "Will the proposed new service be immediately self-supporting or remunerative?" Its duty is measured by what it ought reasonably to be called upon to do. The test sets up reasonableness as the standard, and in its application here as elsewhere it takes into account all relevant circumstances, and has no definite or precise measure. It is clear, however, that in a case like the one before us prospective future returns from the new undertaking is a factor not to be overlooked or passed over slightingly.

Id. (citations and internal quotations omitted).

Levitt is a simplified version of the present case. The essential economic question affecting rates is the same whether the system in question needs to be built in the first instance (as in *Levitt*) or rebuilt (as here). The fact that the Commission's refusal of service rule mentions "new or additional service," likewise, is immaterial because the essential economic effect on rates is the same regardless of whether the System needs to be build or rebuild. In either case, the Commission must consider all relevant facts, consistent with its statutory duty to fix just, reasonable, and nondiscriminatory rates. Here, the Commission properly considered the

economic feasibility of replacing the Maloney Ridge System as one factor in its fact-based analysis.

4. The Commission Properly Determined That the Maloney Ridge Customers Should Pay to Replace the System

The Maloney Ridge Customers presented the Commission with a fact-based ratemaking question, and the Commission answered that question using a fact-based analysis. As the Commission properly determined, the undisputed record evidence establishes that the Maloney Ridge Customers should incur the uneconomic System's replacement costs. Any other conclusion would have been unjust, unreasonable, and discriminatory to PSE's other Schedule 24 customers.

The duty to establish just, fair, reasonable, sufficient rates weighed heavily in the Commission's decision. In setting rates, the Commission "focuses primarily on the principle of cost causation." AR 814. The undisputed evidence showed that no part of the System's costs is recovered in Schedule 24 rates, or in any other tariffed rate. AR 332; *see* AR 814 ("[the Maloney Ridge Customers'] bundled [Schedule 24] rate includes the cost of delivering power through PSE general distribution system to the beginning of the Maloney [System]."). Contrary to the Maloney Ridge Customers' claim, the Commission found "consistent evidence" in the hearing record as well as in the pre-filed testimony and exhibits that

demonstrated that the System had never been part of PSE's distribution system. AR 331 (*Citing* TR. 29:1-15; TR. 61:1-63:19; TR. 72:22-73:18; AR 822-36; AR 597-607; AR 745-46). Consequently, the Commission rejected the same argument that failed to persuade the court in *Levitt*—that the rate impact is reasonable because it would raise Schedule 24 rates a mere 0.2 percent. Br. of Appellant at 49, AR 246, 847. In Order 03, the ALJ rejected the rate impact argument as both unreasonable and missing the point: "Customers who do not cause costs should not be responsible for paying them . . ." AR 246-47. In Order 04, the Commission likewise found: "The general body of Schedule 24 customers does not cause any of the Maloney Ridge [System] costs and should, therefore, bear none of those costs." AR 337. The Commission found the balance of equities disfavored the Maloney Ridge Customers.

Indeed, the cost to replace the System would exceed the revenues that PSE would recover in rates charged to the Maloney Ridge Customers, and thus "would cause an inequitable and unreasonable cross-subsidy to require other customers under Schedule 24 to pay $5 million or more for facilities that will serve only [the Maloney Ridge Customers]." AR 336. In addition, the Maloney Ridge Customers were seeking for the first time to obtain service on the System, not on the basis of their Service Agreements, but as customers being served on PSE's general distribution system under

tariffs of general applicability—in particular, Schedule 24. *Id.* Considering the facts presented, the Commission determined that were it to interpret the Service Agreements and tariff schedules to require PSE to pay to replace the Maloney Ridge System, it would "either have to approve recovery of the capital costs of installing a new, replacement [System] from all Schedule 24 customers, or find such an expenditure imprudent and disallow the costs, requiring it to be absorbed by PSE's shareholders." *Id.* Neither of these outcomes were legally permissible because both produced rates under Schedule 24 that failed to meet the fair, just, reasonable, and sufficient standard. *Id.*

Ultimately, the Commission properly determined that the public interest demanded the Maloney Ridge Customers should pay the lion's share of the replacement cost of the System from which they alone benefit. Specifically, the Commission determined PSE should undertake replacement of the System to the full extent it would be economic to do so—i.e., $335,000. And, if the Maloney Ridge Customers elect that option, they must pay all costs to replace the line in excess of $335,000, as well as all operating and maintenance costs under the same terms and conditions in the existing Service Agreements. AR 338.

C. The Commission Properly Determined That the Tariffs and Service Agreements Do Not Control Who Should Pay to Replace the System

To distract this Court from unfavorable facts, the Maloney Ridge Customers argue that the plain language of PSE's Tariff Schedule 85 controls the outcome of this case as a matter of law. Br. of Appellant at 17-34. Indeed, they argue, "The Court can [] resolve this case on the plain language of Schedule 85 alone." *Id.* at 22. Their "plain language" argument suffers from three fundamental flaws: (1) they misread the plain language Schedule 85; (2) they ignore the plain language of Schedule 80, which is expressly incorporated into Schedule 85; and (3) they neglect the Commission's statutory responsibility, which is to arrive at a just, fair, reasonable, and sufficient result. As the Commission accurately observed, the Maloney Ridge Customers cannot point to any "plain language" that allows them to avoid paying replacement costs because Schedule 85 "does not mention payment responsibility." AR 335. The Commission properly determined that the tariffs and Service Agreements do not control who should pay to replace the Maloney Ridge System.

1. The Maloney Ridge Customers Erroneously Interpret the "Plain Language" of Schedule 85 and Service Agreements

Rates, terms, and conditions for utility service are set forth in the utility's tariff. WAC 480-80-030. Every utility must file with the

Commission all tariff schedules and "all forms of contract or agreement" relating to rates, charges, or service. RCW 80.28.050, WAC 480-100-028. "Once a utility's tariff is filed and approved, it has the force and effect of law." *Gen. Tel. Co. of Nw. v. City of Bothell*, 105 Wn.2d 579, 585, 716 P.2d 879 (1986).

The Maloney Ridge Customers receive electric service from PSE pursuant to their Service Agreements and the provisions of PSE's Electric Tariff G. AR 597-98. The Service Agreements, which govern the operation of the System and the recovery of its costs, expressly refer to PSE's Electric Tariff G, which includes Schedules 80 and 85. AR 626. Schedule 80 comprises the General Rules and Provisions applicable to PSE's electric service. *See* AR 644-46. Schedule 85 governs the terms and conditions applicable to the extension or modification of PSE's electric distribution facilities. *See* AR at 647-66. Service under Schedule 85 is expressly "subject to the General Rules and Provisions" contained in Schedules 80.

The Maloney Ridge Customers erroneously interpret the plain language of Schedule 85 to compel PSE to pay to replace the System and recover the costs in Schedule 24 rates. Their plain language argument relies on the "Ownership of Facilities" provision in Schedule 85, which provides:

> The Company shall own, operate, maintain and repair all electric distribution facilities installed by or for the Company under this schedule, including replacement of such facilities

> if necessary so long as such replacement is not inconsistent with this schedule or a contract governing such facilities.

AR 334-35. The Maloney Ridge Customers argue that this language "obligates PSE to *pay to replace*" the System. Br. of Appellant at 19 (emphasis in original). They ignore the fact that this language does not expressly mention payment responsibility. They also misread the language. The term "including replacement" is used to specify a subset of the aforementioned duties, not a separate category. Replacement thus would not be a distinct category of PSE's ownership responsibility, but rather, one of the many responsibilities included in repairing and maintaining the System.

Interpreting Schedule 85 to include replacement as a notable subset of maintenance and repair would be more consistent with the allocation of costs in the Service Agreements. The Service Agreements govern the operation of the System and the recovery of its costs. AR 626. They expressly provide that PSE owned and operated the System and was "***responsible for repairing and maintaining*** the System, including the furnishing of all necessary labor, materials, and equipment to keep the System in good operating condition," ***but they assigned all of these costs*** to the Maloney Ridge Customers. AR 626-27. When read in conjunction with the Service Agreements, the "Ownership of Facilities" provision more plainly implies that replacement costs were a subset of the maintenance and

repair costs that the Maloney Ridge Customers agreed to pay to keep the System in good operating condition. This reading is also consistent with the historic allocation of System costs, which the Service Agreements assigned to the Maloney Ridge Customers from cradle to grave by expressly assigning them all construction costs, all costs necessary to keep the System in good operating condition, and all removal costs. AR 614, 626-628.

The Maloney Ridge Customers infusing meaning into textual silence of Schedule 85 by citing dictionary definitions and emphasizing statutory construction arguments. Br. of Appellant at 21-22. While Schedule 85, read in conjunction with the Service Agreements, more plainly implies that replacement costs were a subset of the maintenance and repair costs that the Maloney Ridge Customers agreed to pay, this still requires an interpretive approach.

The Maloney Ridge Customers also attempt to thrust costs on all Schedule 24 customers by arguing that where PSE intends to transfer cost responsibility to customers, it does so in express language. Br. of Appellant at 23. But this approach fails because the tariff language they cited indicated that in all circumstance the customer, not PSE, pays the costs associated with replacement. *See* AR 244, 335, 658. Accordingly, the Commission correctly found that plain language of Schedule 85 "does not mention payment responsibility and it would be inappropriate to interpret that silence

to reflect PSE's intent to pay all costs associated with [replacement]." AR 335 (internal citations omitted).

2. The Maloney Ridge Customers Willfully Ignore the Plain Language of Schedule 80

PSE's Schedule 80 contains the General Rules and Provisions governing its electric service to customers. AR 601. The General Rules and Provisions of Schedule 80 govern the services provided under Schedule 85 and Schedule 24. AR 601. Schedule 85 and Schedule 24 each expressly incorporate Schedule 80. *See* AR 665. Under the express terms of Schedule 80's Section 9: "The Company shall not be required to provide service if to do so would be economically unfeasible." AR 644. This language is clear and without ambiguity as to intent.

The Maloney Ridge Customers argue that that PSE's right under Schedule 80 to deny service for economic reasons is somehow limited to new or additional services. Br. of Appellant at 32. While other provisions in Section 9 of Schedule 80 articulate such limitations, the economic feasibility clause does not. AR 644. The testimony provided by expert witnesses further demonstrated that the economic feasibility threshold is in no way limited to new or additional services. Mr. Logen, PSE's Supervisor of Tariffs, testified that the plain language of Section 9 provides no exception to the economic feasibility requirement. AR 674. He pointed out

that while certain paragraphs of Section 9 "refer to connection of service or additional service," the economic feasibility language "stands on its own" and refers to "any service provided under Schedule 80." *Id.* Commission Staff witness Mr. Nightingale also testified to the general applicability of Section 9's economic feasibility language. He too concluded that PSE would not be required to build a replacement facility, unless PSE found it "economically feasible to do so." AR 827. The weight of testimony before the Commission made clear that the economic feasibility language found in Section 9 makes perfectly clear that PSE is required to provide service only when it is economically feasible to do so.

The Commission's final order addressed the tariff's economic feasibility requirement, citing verbatim Section 9 of Schedule 80. AR 337. It further explicitly rejected the notion that PSE's tariffs were somehow inapplicable to the Maloney Ridge Customers' case. Yet, the Commission was also unwilling to find that the provision was dispositive of who should pay to replace the System. AR 334, 337. As discussed above in Section B.3, the Commission expressed concern that the concept of economic feasibility is "overly broad and ambiguous". *Id.* It also echoed the ALJ's concerns that PSE would apply the economic feasibility provision "to deny or terminate service to any individual customer if the revenues PSE receives do not exceed the Company's calculations of the costs it incurs to serve that

particular customer." AR 242, 334, 337. In essence, the Commission was concerned about PSE's ability to abuse or exploit the economic feasibility provision to pick and choose customers, without Commission review, in a manner inconsistent with the public interest. Wholly consistent with its refusal of service rule, the Commission declined to allow PSE to apply the provision without it undertaking a fact-specific analysis to determine a just, fair, reasonable, and sufficient outcome.

3. The Maloney Ridge Customers' Erroneous "Plain Language" Construction of Schedule 85 Would Merely Postpone Commission Review of System Replacement Costs to PSE's Next General Rate Case

In rate cases, the Commission determines the aggregate costs that comprise the utility's allowed revenue requirement and based thereon "establishes the maximum rates the utility can charge for its products to each class of customers." *People's Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm'n*, 104 Wn.2d 798, 809, 711 P.2d 319 (1985). "A major goal of cost allocation is the avoidance of cross-subsidization between classes of customers . . ." Leonard Saul Goodman, *The Process of Ratemaking*, 374 (1998). To achieve this goal, the Commission must establish that rates "yield a reasonable compensation for the service rendered . . ." *See* RCW 80.28.020.

The Maloney Ridge Customers' erroneous interpretation of the "plain language" of Schedule 85 is ultimately a red hearing because it would merely postpone Commission review of the System's replacement costs to a future rate case. Importantly, the Maloney Ridge Customers attempt to link proper allocation of the System's replacement costs to Schedule 24 rates by making an argument about unlawful discriminatory treatment. *See* Br. of Appellant at 43-47. Thus, their erroneous interpretation of Schedule 85 does not ultimately proscribe that all Schedule 24 customers should all pay to replace the System; it would merely result in PSE first replacing the System and then requesting recovery of the costs in a subsequent rate case. In that future rate case, the Commission would have to review the costs and if prudently incurred allocate them to rates. *See People's Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm'n*, 104 Wn.2d 798, 809, 711 P.2d 319 (1985). The Maloney Ridge Customers initial petition to the Commission recognized this fact by asking the Commission for an order declaring that "PSE should replace the [System] and include all of the capital costs of such replacement in its generally applicable rates when it files its next general rate proceeding." AR 25. Thus, even under the Maloney Ridge Customers' erroneous interpretation of Schedule 85, the Commission would still have an opportunity to determine if allocation to Schedule 24 rates is proper.

As discussed above, this is fundamentally a ratemaking case subject to Commission's overarching statutory duty to fix just and reasonable rates after consideration of the relevant facts and circumstance. RCW 80.28.010, .020. The Maloney Ridge Customers attempt to gloss over the Commission's broad ratemaking authority to allocate costs in order to pin the costs to replace the System on all Schedule 24 customers. Their argument invites this Court to preempt the Commission's ratemaking authority to review and allocate the System's replacement costs. This Court should decline their invitation.

D. The Maloney Ridge Customers' Erroneous "Plain Language" Interpretation of the Tariff and Service Agreements Would Produce Rates That Fail To Meet the Statutory Standards

The Maloney Ridge Customers argue that the Commission unlawfully discriminated against them by finding that they should pay the System's replacement costs. Br. of Appellant at 43-47. Specifically, they argue, "One a utility establishes customer rate classifications, it must treat all members of a class equally and thus cannot charge what is in essence a higher rate to a subset of customers in a class." Br. of Appellant at 43 (citing *Rustlewood Ass'n v. Mason Cty.*, 96 Wn. App. 788, 794, 981 P.2d 7 (1999)). Importantly, *Rustlewood* is inapposite because it addresses statutes not applicable to the Commission, but rather to county-regulated sewerage, water, and drainage systems. *See* RCW 36.94. The statute at issue in

Rustlewood was more prescriptive than the one applicable here. *Compare* RCW 36.94.140 *with* RCW 80.28.100. Moreover, *Rustlewood* addressed a retroactive ratemaking issue, not a prospective one as is the case here.

When allocating costs, the Commission must avoid the creation of an unreasonable preference and undue discrimination. RCW 80.28.090, .100. Consequently, it must establish the same rates for "like or contemporaneous service . . . under the same or substantially similar circumstances or conditions." RCW 80.28.100. Yet, "A mere difference in rates does not, of itself, constitute an unlawful discrimination. A comparison of rates may be persuasive and may be controlling, but only when it is also shown that the conditions are comparable and that the rates used for comparison are just, fair, reasonable, and sufficient." *Cole v. Wash. Utils. & Transp. Comm'n*, 79 Wn.2d 302, 310-11, 485 P.2d 71 (1971) (internal citations omitted).

The Maloney Ridge Customers are not similarly situated to other Schedule 24 customers. *See* AR 813-14. And they offered no persuasive evidence to the contrary. AR 240. The Maloney Ridge Customers alone are served by the System and have been responsible for all of its costs to date. AR 329, 332. Replacement of the System is not economically feasible because the costs to replace the line vastly exceed the amount PSE would recover in rates charged to the Maloney Ridge Customers. AR 336.

Consequently, having all Schedule 24 customers pay for replacement would provide an inequitable and unreasonable cross-subsidy. It would also create a windfall to the Maloney Ridge Customers.

The Commission found this result would be unlawful. Indeed, applying a fact-based analysis the Commission correctly determined that the Maloney Ridge Customers' requested allocation of the System's replacement costs was not "legally permissible" because it would "lead to rates under Schedule 24 that would fail to meet the fair, just, reasonable, and sufficient standard." AR 332.

This Court should affirm the Commission's final Order 04 to avoid an unwarranted windfall to the Maloney Ridge Customers and the corresponding harms to the non-benefitting Schedule 24 customers.

V. CONCLUSION

For the reasons stated above, this Court should affirm the Commission's final Order 04. The Commission properly executed its ratemaking authority to determine that the Maloney Ridge Customers should pay to replace the System from which they alone benefit and have historically borne all costs. The Commission's final Order 04 is supported by undisputed evidence and is not arbitrary or capricious. Moreover, the Commission's final Order 04 avoids an unwarranted windfall to the

Maloney Ridge Customers and the corresponding harms to the non-benefitting Schedule 24 customers.

RESPECTFULLY SUBMITTED this 17th day of November 2016.

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DATED this 12th day of August 2016.

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WASHINGTON STATE ATTORNEY GENERAL

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